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The Housing Assistance Tax Act of 2008

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The Housing Assistance Tax Act of 2008

-by Neil E. Harl*

Although most of the American Housing Rescue and Foreclosure Prevention Act of 2008¹ is devoted to programs to stabilize the U.S. housing sector, one division, the Housing Assistance Tax Act of 2008,² contains several significant changes in tax law.³ Most of the changes are not effective until 2009 which provides an opportunity to do some planning in 2008.

First time home buyer credit

Under the 2008 law, a taxpayer who is a first-time home buyer is eligible for a 10 percent (of the purchase price) refundable tax credit equal to the lesser of \$7,500 (\$3,750 for a married taxpayer filing separately) or 10 percent of the purchase price of a "principal residence."⁴ The credit phases out for individual taxpayers with modified adjusted gross income in the year of purchase between \$150,000 and \$170,000 for joint filers, \$75,000 to \$95,000 for those married filing separately.⁵ An individual is considered a first time home buyer if the individual had no ownership interest in a principal residence in the United States during the three-year period prior to the purchase of the home to which the credit applies.⁶ A residence constructed by the taxpayer is treated as purchased by the taxpayer on the date the taxpayer first occupies the residence.⁷

No credit is allowed if (1) the District of Columbia homebuyer credit is allowable for the taxable year the residence is purchased or a prior taxable year; (2) if the taxpayer's financing comes from tax-exempt mortgage revenue bonds; (3) if the taxpayer is a nonresident alien; or (4) the taxpayer disposes of the residence (or it ceases to be a principal residence) before the close of a taxable year for which a credit otherwise would be allowable.⁸

The credit is recaptured over 15-years⁹ with no interest charge beginning in the second taxable year after the taxable year in which the home was purchased.¹⁰ Actually, the taxpayer's income tax is increased by 6 2/3 percent of the amount of the credit for each taxable year in the recapture period.¹¹ In the event the taxpayer sells the home or the home ceases to be used as the principal residence of the taxpayer or the taxpayer's spouse, before complete repayment of the credit, any remaining credit amount is due on the return for the year the home is sold or ceases to be used as the principal residence.¹² The credit repayment amount, however, is not to exceed the amount of gain from the sale of the residence to an unrelated person.¹³ Gain is determined, for this purpose, by reducing the income tax basis of the property by the amount of the credit not already recaptured.¹⁴ But no gain is recaptured after the death of the taxpayer¹⁵ and, in the case of an involuntary conversion, there is no recapture is a new principal residence if acquired within a two-year

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period.¹⁶ In the case of a transfer incident to a divorce, the transferee spouse is responsible for any future recapture, not the transferor spouse.¹⁷

The provision is effective for qualifying home purchases on or after April 9, 2008, and before July 1, 2009 (without regard to whether there was a binding contract to purchase prior to April 9, 2008).¹⁸ A taxpayer purchasing a principal residence after December 31, 2008 and before July 1, 2009, may elect to treat the purchase as made on December 31, 2008.¹⁹

Additional standard deduction for state and local property taxes

The 2008 Act increases an individual's standard deduction²⁰ for taxable years beginning in 2008 by the lesser of (1) the amount allowable to the taxpayer as a deduction for state and local taxes (relating to real property)²¹ or (2) \$1,000 for a married taxpayer filing jointly (\$500 for a married filing taxpayer filing separately).²² If the actual amount of property taxes paid is less than the deduction amount, only the amount actually paid can be deducted.²³ No taxes which are deductible in computing adjusted gross income can be taken into account in computing the increased standard deduction.²⁴

This provision is effective for taxable years beginning after December 31, 2007.²⁵

Limits on the I.R.C. § 121 exclusion

One of the revenue raisers in the 2008 legislation involves limits imposed on the exclusion of part or all of the gain on sale of the principal residence.²⁶ Under that provision, an individual who is married and files a joint return can exclude up to \$500,000 (\$250,000 if married and filing separately), from the sale or exchange of the principal residence²⁷ provided the taxpayer has owned and used the residence as the principal residence for at least two of the last five years ending with the sale or exchange.²⁸ A taxpayer who is unable to meet those requirements because of a change in employment, health or certain unforeseen circumstances, may exclude an amount equal to the fraction of the maximum allowable exclusion equal to the fraction of the two years that the ownership and use requirements are met.²⁹

Under the new 2008 law, gains from the sale or exchange of a principal residence allocated to periods of nonqualified use are not excluded from income.³⁰ The amount of the gain allocated to periods of nonqualified use is the amount of the gain multiplied by a fraction the numerator of which is the aggregate periods of nonqualified use during the period the property was owned by the taxpayer; the denominator is the period the taxpayer owned the property.³¹ A "period of nonqualified use" means any period (but not including any period before January 1, 2009) during which the property is not used by the taxpayer or taxpayer's spouse or former spouse as a principal residence.³²

Example: an individual purchases a residence on January 1, 2009, for \$400,000 and uses it as a rental property for two years, claiming \$20,000 of depreciation on the property. On

January 1, 2011, the taxpayer converts the property to the principal residence. On January 1, 2013, two years later, the taxpayer moves out of the house and, on January 1, 2014, sells the property for \$700,000. As is the case at present, the \$20,000 of gain attributable to the depreciation is included in income. However, of the remaining gain, 40 percent of the gain (two years divided by five years) is allocated to "nonqualified use" and is not eligible for the exclusion. The remaining gain would be eligible to be excluded from income.³³

It is important to note that any part of the five-year period which is after the last qualified use does not constitute nonqualified use.³⁴ Likewise, the period of nonqualified use does not include any period (up to 10 years) during which the taxpayer or the taxpayer's spouse is serving on "qualified official extended duty."³⁵ Parallel to prior law, any period of temporary absence (not to exceed two years) due to change of employment, health conditions or other unforeseen circumstances does not count as nonqualified use.³⁶

The new statute makes it clear that the limits enacted in 2008 apply after the depreciation adjustments applicable to periods after May 6, 1997³⁷ with respect to the property;³⁸ moreover, the allocation of gains to periods of nonqualified use apply without regard to any depreciation adjustments in the post-May 6, 1997 period.³⁹

The provision is effective for sales and exchanges after December 31, 2008.⁴⁰

FOOTNOTES

¹ Pub. L. No. 110-289, 110th Cong., 2d Sess. (2008).

² Pub. L. No. 110-289, Division C, 110th Cong., 2d Sess. (2008).

³ See generally Joint Committee on Taxation, "Technical Explanation of Division C of H.R. 3221, The 'Housing Assistance Tax Act of 2008,' " JCX 63-08, July 23, 2008.

⁴ I.R.C. § 36(a).

⁵ I.R.C. § 36(b)(2). The term "modified adjusted gross income" means the taxpayer's adjusted gross income increased by any amount excluded under I.R.C. §§ 911, 931 and 933.

⁶ I.R.C. § 36(c)(1).

⁷ I.R.C. § 36(c)(3)(B).

⁸ I.R.C. § 36(d).

⁹ I.R.C. § 36(f)(7).

¹⁰ I.R.C. § 36(f).

¹¹ I.R.C. § 36(f)(2).

¹² *Id.*

¹³ I.R.C. § 36(f)(3).

¹⁴ *Id.*

¹⁵ I.R.C. § 36(f)(4)(A).

¹⁶ I.R.C. § 36(f)(4)(B).

¹⁷ I.R.C. § 36(f)(4)(C).

¹⁸ I.R.C. § 36(h).

¹⁹ I.R.C. § 36(g).

²⁰ I.R.C. § 63(c).

²¹ I.R.C. §§ 164(a)(1), 63(c)(1)(C), (c)(7). See also I.R.C. § 216 (for tenant-stockholders in a cooperative housing corporation).

²² I.R.C. § 63(c)(7)(B).

²³ I.R.C. § 63(c)(7)(A).

²⁴ I.R.C. § 63(c)(7).

²⁵ Housing Assistance Act of 2008, Pub. L. 110-289, § 3012(a).

²⁶ I.R.C. § 121. See generally 6 Harl, *Agricultural Law* § 48.02[5] (2008); Harl, *Agricultural Law Manual* § 6.03[2] (2008); 1 Harl, *Farm Income Tax Manual* § 2.12[3] (2008). See also Harl, "Section 121 Exclusion and Like-Kind Exchange on Same Property," 16 *Agric. L. Dig.* 17 (2005); Harl, "Excluding Gain on Sale of Residence," 14 *Agric. L. Dig.* 105 (2003); Harl, "More Detail on the Principal Residence Exclusion," 14 *Agric. L. Dig.* 9 (2003).

²⁷ I.R.C. § 121(a).

²⁸ *Id.*

²⁹ I.R.C. § 121(c).

³⁰ I.R.C. § 121(b)(4)(A).

³¹ I.R.C. § 121(b)(4)(B).

³² I.R.C. § 121(b)(4)(B) (i).

³³ I.R.C. § 121(a).

³⁴ I.R.C. § 121(b)(4)(C)(ii)(I).

³⁵ I.R.C. § 121(b)(4)(C)(ii)(II).

³⁶ I.R.C. § 121(b)(4)(C)(ii)(III).

³⁷ I.R.C. § 121(d)(6).

³⁸ I.R.C. § 121(b)(4)(D)(i).

³⁹ I.R.C. § 121(b)(4)(D)(ii).

⁴⁰ Housing Assistance Tax Act of 2008, Pub.L. 110-289, § 3092(a).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

CHAPTER 12

MODIFICATION OF PLAN. The debtor's estate included improved real property, 11.2 acres, which was valued on the bankruptcy schedules at \$40,000. The Chapter 12 plan provided for payment of a loan secured by the property and removal of the lien. Two years after the plan was confirmed, the property was subject to condemnation by the State of Texas for highway expansion and the state offered to pay \$175,000 for six acres of the property. The creditors sought modification of the plan to provide that any proceeds of the condemnation would be applied to payment of unsecured creditors. The creditors argued that the condemnation award was an unforeseen circumstance and would result in a windfall to the debtor if not applied to the unsecured claims. The Bankruptcy Court granted the modification of the plan because the condemnation proceeds were disposable income to the debtor and were not necessary for the debtor to continue farming. The appellate court affirmed. **Conner v. First National Bank-Haskell, 2008 U.S. Dist. LEXIS 53555 (N.D. Tex. 2008).**

FEDERAL TAX

SALE OF CHAPTER 12 ESTATE PROPERTY. The debtor filed for Chapter 12 and, with permission of the Bankruptcy Court, sold the debtor's farm, resulting in \$29,000 of capital gain. The debtor's plan included the capital gains as an unsecured claim to be paid to the extent of other unsecured claims. The IRS objected to the plan, arguing that the capital gains were the post-petition personal responsibility of the debtor

because no taxable entity was created in the bankruptcy estate. The debtor cited *In re Knudsen, 389 B.R. 643 (N.D. Iowa 2008)*, *aff'g in part, 356 B.R. 480 (Bankr. N.D. Iowa 2006)*, which held that, under Section 1222(a)(2)(A), taxes generated by the sale of Chapter 12 estate property could be treated as unsecured claims of the estate. The Bankruptcy Court in this case had rejected the holding of *In re Knudsen*, and held that the statute was clear that no separate taxable entity was created in Chapter 12 proceedings, therefore, post-petition sales of estate property were taxable to the debtor personally. The Bankruptcy Court also had held that the taxes were not entitled to the administrative expenses exception in Section 1222(a)(2)(A) because the taxes were not entitled to priority under Section 507. On appeal the District Court reversed, holding that, in accordance with *In re Knudsen, In re Dawes, 382 B.R. 509 (Bankr. D. Kan. 2008)*, and *In re Schilke, 379 B.R. 899 (Bankr. D. Neb. 2007)*, the legislative history and purpose of Section 1222(a)(2)(A) required that income taxes resulting from postpetition sales of a Chapter 12 debtor's property were administrative expenses entitled to application of Section 1222(a)(2)(A). See Harl, "District Court in Knudsen Holds for Debtors in Chapter 12 Case," 19 *Agric. L. Dig.* 101 (2008). ***In re Hall, CV-07-679-TUC-DCB (D. Ariz. Aug. 6, 2008), rev'g, 376 B.R. 741 (Bankr. D. Ariz. 2007).***

The IRS has filed an appeal of *In re Knudsen, 389 B.R. 643 (N.D. Iowa 2008)*, *aff'g in part, 356 B.R. 480 (Bankr. N.D. Iowa 2006)* (capital gains taxes resulting from postpetition sales of a Chapter 12 debtor's property were administrative expenses entitled to application of Section 1222(a)(2)(A)).